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 Evelyn Asher Sheerin, Trustee for the benefit of The Chris
 H. Sheerin (deceased) and Evelyn Asher Sheerin 1984 Trust
 Dated 5/31/84; Evelyn Asher Sheerin, Trustee of the
 Chris and Evelyn Sheerin 1990 Trust; Sheerins Inc.;
 Bruce Corum, Trustee of the Credit Shelter Trust; Juanita
 N. Carter; Charles B. Anderson Trust; Rita P. Anderson
 Trust; Baltes Company; The Mault Family Trust; Kehl Family;
 and Sierra Health Services, Inc. ("JV Direct Lenders")

UNITED STATES BANKRUPTCY COURT

DISTRICT OF NEVADA

In re:

USA COMMERCIAL MORTGAGE COMPANY,
Debtor.

Case No. BK-S-06-10725-LBR
 Case No. BK-S-06-10726-LBR
 Case No. BK-S-06-10727-LBR
 Case No. BK-S-06-10728-LBR
 Case No. BK-S-06-10729-LBR

USA CAPITAL REALTY ADVISORS, LLC,
Debtor.

USA CAPITAL DIVERSIFIED TRUST DEED FUND,
LLC,

Chapter 11
**JV DIRECT LENDERS' PARTIAL
OPPOSITION TO DEBTORS'
MOTION TO DISTRIBUTE
FUNDS AND TO GRANT
ORDINARY-COURSE RELEASES
AND DISTRIBUTE PROCEEDS
(AFFECTS USA COMMERCIAL
MORTGAGE, USA CAPITAL
DIVERSIFIED TRUST DEED
FUND, AND USA CAPITAL FIRST
TRUST DEED FUND)**

Debtor.

USA CAPITAL FIRST TRUST DEED FUND, LLC,
Debtor.

USA SECURITIES, LLC,

Debtor.

Affects:

- All Debtors
- USA Commercial Mortgage Company
- USA Capital Realty Advisors, LLC
- USA Capital Diversified Trust Deed Fund, LLC
- USA Capital First Trust Deed Fund, LLC
- USA Securities, LLC

Hearing Date: August 4, 2006
 Hearing Time: 1:30 p.m.

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1 Jones Vargas represents numerous direct lenders who are named beneficiaries ("JV Direct
 2 Lenders," specified in the caption) of certain loans which were originated and serviced by Debtor
 3 USA Commercial Mortgage Co. (hereinafter, "Debtor" or "USA Commercial"). The JV Direct
 4 Lenders are among the roughly 3,600 direct lenders who provided funds for loans originated and
 5 serviced by USA Commercial. The JV Direct Lenders hereby filed their Partial Opposition to
 6 Debtors' Motion to Distribute Funds and to Grant Ordinary-Course Releases and Distribute
 7 Proceeds (Ct. Dkt. #s 847, 880, Debtor's Motion & Supplement), based upon the attached
 8 Memorandum of Points and Authorities, the pleadings and papers on file herein, and any other
 9 material this Court may wish to consider.

10 **Discussion & Analysis**

11 The JV Direct Lenders supports Debtors' proposal to distribute the borrower funds held by
 12 Debtors to their rightful owners, the direct lenders. However, the JV Direct Lenders oppose
 13 Debtors' proposed net distribution based on the equitable theory of recoupment.

14 **A. Debtors Provide No Evidence That Allows for a Substantive Response**

15 Once again, debtors have moved for an order without providing any evidence to
 16 substantiate their position. Moreover, the dearth of evidence makes it impossible for the JV Direct
 17 Lenders to substantively respond to the motion. Debtors propose distributing \$64.7 million (Ct.
 18 Dkt. #880, Debtor's Supplement), yet they have not provided any information to the Court or
 19 direct lenders about how much they intend to distribute to individual JV Direct Lenders or the
 20 thousands of other direct lenders. Debtors' motion states: "The actual amounts sought to be
 21 distributed are still being reconciled and determined by the Debtors' post-petition management,
 22 and will be supplied shortly in a supplemental filing" (Ct. Dkt. #847, Motion at 2). Debtors'
 23 supplemental filing provides just a lump sum, \$64.7 million (Ct. Dkt. #880, Supplement).

24 The closest that debtors come to disclosing distribution information about individual JV
 25 Direct Lenders is with a statement that they "project[]" they will have statements "ready to mail
 26 out of the Direct Lenders on or about July 19, 2006." *Id.* (emphasis added). This means Debtors
 27 did not expect to provide the specifics of their proposals to the individual JV Direct Lenders until
 28 two weeks after they filed this motion. Moreover, Debtors expressly state that there is no

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1 guarantee that this proposed distribution is accurate. The Direct Lender statements "remain
 2 subject to revision and correction" (Ct. Dkt. #847, Motion at 4 & 5), Debtors expect to change the
 3 distribution amount due to inaccurate statements (Ct. Dkt. #880, Supp. at 2 n.1), and Debtors
 4 refuse to waive any rights to recalculate the proper amount for distribution, even after distribution
 5 (Ct. Dkt. #880, Motion at 7). To date, counsel for the JV Direct Lenders has not received any
 6 statements, making it impossible to assess the impact of debtors' proposed distribution.

7 Debtors, by their own admission, brought this motion before they had evidence to
 8 substantiate their conduct. By bringing the motion without evidence—and just the naked promise
 9 that information would be forthcoming—Debtors make it impossible for JV Direct Lenders to
 10 substantively respond. This is a recurring problem. Debtors continually make statements without
 11 any evidentiary support, not even affidavits from debtors' employees. When JV Direct Lenders
 12 and other direct lenders ask Debtors to substantiate the basis for their proposals, Debtors simply
 13 respond that they are still reviewing and assessing the lender and borrower records. Yet when
 14 Debtors want to do something that benefits them, the numbers are readily available. Debtors'
 15 conduct—submitting motions without evidentiary support—should not be tolerated.

16 **B. Debtors Violate Direct Lenders' Rights by Netting Proceeds From Different Loans**

17 Debtors violate the JV Direct Lenders' rights with their proposal to make individual
 18 distributions based on a net assessment of the different loans in which individual JV Direct
 19 Lenders participated. Debtors effectively terminate the individual JV Direct Lenders' rights in
 20 payments on individual loans, rights that are secured by loan documents, security agreements, and
 21 deeds of trust.

22 As Debtors explained, they propose to take all the loans that an individual direct lender
 23 funded, then distribute the net amount based on the difference between the amount Debtors still
 24 owe each direct lenders, and any prior excess distribution to the individual direct lenders. This net
 25 distribution ignores the rights that the individual JV Direct Lenders have in each loan they
 26 partially funded. The record is replete with evidence, showing that individual direct lenders are
 27 the parties that entered into the loan agreements, the named beneficiaries, and specifically secured
 28 by deeds of trust. To the extent that individual loans are performing post-petition, the direct

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1 lenders in those loans are entitled to the borrower payments, regardless of whether the individual
 2 direct lenders were "overpaid" in other loans.

3 **C. Debtors Must Bring an Adversary Proceeding to Recover Money Owed to the Estate**

4 By proposing net distributions, Debtors attempt to avoid the requirement that a debtor
 5 bring an adversary proceeding. Federal Rule of Bankruptcy Procedure 7001(1) unequivocally
 6 states that "a proceeding to recover money property of the estate" must be brought as an adversary
 7 proceeding. Debtors' motion seeks to recover pre-petition "excess" distributions that they made to
 8 certain direct lenders by offsetting that amount against post-petition collections. This is a veiled
 9 attempted to collect money allegedly owed to the estate, and must be brought as an adversary
 10 proceeding. Fed. R. Bankr. P. 7001(1). Debtors claim it is too expensive to bring adversary
 11 proceedings (Ct. Dkt. #847, Motion at 9), but this does not constitute a legal argument that allows
 12 Debtors to ignore the requirements of the Federal Rules of Bankruptcy Procedure.

13 **D. Debtors' Cannot Proceed under Recoupment Unless They Bring an Adversary Action**

14 Recoupment, in its essence, is a method to recover money or property of the estate. As
 15 Judge Markell explained, "Recoupment involves a netting out of debt arising from a single
 16 transaction." *Leonard v. Optimal Payments Ltd. (In re National Audit Defense Network)*, 332
 17 B.R. 896, 913 (Bankr. D. Nev. 2005) (emphasis added; quotation & citation omitted). A debt is
 18 nothing more than money owed to the estate. *See* 11 U.S.C. § 101(12). Thus, to raise
 19 recoupment, Debtors must bring an adversary proceeding pursuant to Federal Rule of Bankruptcy
 20 Procedure 7001(1). *See, e.g., Reiter v. Cooper*, 507 U.S. 258, 265 n.2 (1993) ("It is well settled,
 21 moreover, that a bankruptcy defendant can meet a plaintiff-debtor's claim with a counterclaim
 22 arising out of the same transaction, at least to the extent that the defendant merely seeks
 23 recoupment." (emphasis added)); *see also, e.g., Sims v. United States (In re TLC Hosps., Inc.)*, 224
 24 F.3d 1008 (9th Cir. 2000) (raising recoupment in adversary proceeding); *Newberry Corp. v.*
 25 *Fireman's Fund Ins. Co.*, 95 F.3d 1392 (9th Cir. 1996) (same); *Montana v. Goldin (In re Pegasus*
 26 *Gold Corp.)*, 296 B.R. 227, 242 (D. Nev. 2003) (Hagen, J.) (same), *reversed in part on other*
 27 *grounds*, 394 F.3d 1189 (9th Cir. 2005); *Leonard*, 332 B.R. at 911-14 (same); *Aureal, Inc. v. I/O*
 28 *Magic Corp. (In re Aureal, Inc.)*, 279 B.R. 573 (Bankr. N.D. Cal. 2002) (same).

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1 **E. Even if Recoupment Can be Raised, There Are No Mutual Debts**

2 The Debtors do not "owe" money to the direct lenders. Debtors are merely the servicing
 3 agent that collects the borrower payments legally owed to the direct lenders. Since there are no
 4 mutual debts that can be set off, recoupment does not apply in this situation. See *Leonard*, 332
 5 B.R. at 913-14 (discussing recoupment).

6 The *Restatement on Restitution* is clear:

7 A creditor of another [a direct lender] or one having a lien on another's
 8 property [a direct lender] who has received from a third person [the debtor]
 9 any benefit in discharge of the debt or lien [a payment from the debtor
 10 reducing the borrower's debt], is under no duty to make restitution therefore,
 although the discharge was given by mistake of the transferor [the debtor] as to
 his interests or duties, if the transferee [direct lender] made no
 misrepresentation and did not have notice of the transferor's mistake.

11 *Restatement of Restitution* § 14(1) (1936). In the present case, the direct lenders made no
 12 misrepresentations and did not have notice of the transferor's mistake. Debtors' alleged excess
 13 pre-petition payments were made with reference to the existence of the debt or lien, and not with
 14 reference to the duty or interest of the transferor. Hence, it would be inequitable to require
 15 restitution from the transferee, since, in reducing the debt or lien, the direct lender has given value.

16 The JV Direct Lenders also join Direct Lender Alexander's opposition as to the argument
 17 that the direct lenders do not owe a debt to Debtors (Ct. Dkt. #905). As the Alexander opposition
 18 explained, Debtors willfully made allegedly excess payments to the direct lenders, and the direct
 19 lenders received these payments in good faith and in regular course of business. Therefore, to the
 20 extent that Debtors made allegedly excess payments to direct lenders, these payments are loans
 21 that Debtor made to the borrowers in order to pay the direct lenders. Therefore, Debtors' cause of
 22 action is against the borrowers, not the direct lenders. See Ct. Dkt. #905, Alexander Opp., citing
 23 *Restatement of Restitution* §§ 13-14 (1936); *Chase Manhattan Bank v. Burden*, 489 A.2d 494, 497
 24 (D.C. App. 1985); and *Greenwald v. Chase Manhattan Mortgage Corp.*, 241 F.3d 76, 79 (1st Cir.
 25 2001). The direct lenders do not owe a debt to Debtors, and there is nothing that offsets Debtors'
 26 debts to the direct lenders.

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Conclusion

2 Debtors' motion should be denied to the extent it seeks to make a net distribution. From a
3 procedural perspective, Debtors fail to provide any evidence to allow JV Direct Lenders to assess
4 and substantively respond to the motion. Regardless, Debtors' legal propositions are flawed.
5 Debtors' proposed "net distribution" violates the direct lenders' contractual rights to payments in
6 individual loans, since the direct lenders are secured parties specifically identified in the loans.
7 Furthermore, the proposed "net distribution" simply is an attempt to recover estate property,
8 which, therefore, must be brought as an adversary proceedings pursuant to Rule 7001(1). The lack
9 of adversary proceedings also precludes Debtors' reliance on the equitable theory of recoupment.
10 Finally, even if recoupment may be appropriate, it is not applicable because there are no mutual
11 debts between Debtors and direct lenders.

12 The JV Direct Lenders support the distribution of the funds legally owed to the direct
13 lenders. However, they oppose the motion to the extent that Debtors attempt to collect property of
14 the estate through their proposed "net distribution."

DATED this 27th day of July, 2006.

JONES VARGAS

By: //s// Janet L. Chubb
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23 charge, or if no one is in charge by leaving the document(s) in a
24 conspicuous place in the office.

25 **9** For a party, delivery was made by handing the document(s) to the
26 party or by leaving the document(s) at the person's dwelling house
27 or usual place of abode with someone of suitable age and discretion
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29 **9 f. By messenger:**

30 I served the document(s) by placing them in an envelope or package
31 addressed to the persons at the addresses listed blow and providing them to
32 a messenger for service. (A declaration by the messenger must be attached
33 to this Certificate of Service).

34 **I declare under penalty of perjury that the foregoing is true and correct.**

35 DATED this 27th day of July, 2006.

36 J. Englehart & Tawney Waldo
37 Name

38 //s// Tawney Waldo & J. Englehart
39 Signature

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